Not Chapter 11 but Chapter 11-ish

Howard Morris looks at whether there is a shift towards a US method for resolving insolvency in the UK.

Parents, headmasters, hoteliers, restauranteurs, insurers and countries love them or hate them, depending on how their school or restaurant, company or nation is ranked. I'm referring to the World Bank's annual *Doing Business*, for countries, league[1] tables of course. For all their flaws, league tables are everywhere, and the World Bank is closely followed by our government and others[2]. The UK's plans for reforming insolvency law are profoundly informed by its ranking for the ease and efficiency of doing business and its ambition to move up the tables.

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Slipping down the ladder

To climb the World Bank league table the UK must move closer to the best practices and rubrics of the World Bank in each of the areas on which it is scored. We've slipped down the insolvency ranking since the scoring system changed and to climb again we must change, or 'close the distance to frontier of best practice' as the World Bank describes it. That is why the reforms proposed last spring by the Insolvency Service[3] were so redolent of Chapter 11, because certain elements of Chapter 11 are baked into the World Bank's (and UNCITRAL's) vision of best practice for an insolvency system.

We could stick with what we have, because we have a very fine system, but other parts of the world are reforming like fury and are seeking to seize the UK's crown as the centre for international restructurings. Most recently, the EU Commission has started a massive, heaving effort to modernise EU members' insolvency laws in order to push the EU up those same World Bank rankings[4]. We likely won't be part of the EU when those reforms come to fruition but doesn't it matter if the UK is left behind?

There is a deeper reason for embracing, or at least accepting, change and one that goes to the very philosophical heart of why nations need efficient insolvency systems. There is a pressing need for the UK to bring its insolvency laws closer into line with the World Bank's vision, all the more so as we aim to remain a leading capital market and economy after Brexit.

Changing scales

In its 2015 rankings, the World Bank had changed its approach to its 'resolving insolvency' analysis. That year the UK fell from 7th place to 13th, where we have languished since. In contrast the USA leapt from 14th place to 4th, and for 2016 and 2017 it has ranked 5th for resolving insolvency. What happened?

Until the 2015 rankings the World Bank's assessment for resolving insolvency was calculated on the time, cost and outcome for creditors. The UK did, and still does, very well on these measures. But the World Bank introduced a new measure to determine the strength of an insolvency framework. This new metric assesses the extent to which the best practices championed by the World Bank and UNCITRAL are represented in the country's insolvency regime.

The World Bank and UNCITRAL have been working on this topic for years. The World Bank has produced its *Principles for Effective Insolvency and Creditor/Debtor Regimes*[5] and UNCITRAL its *Legislative Guide on Insolvency law*[6]. These have been married together in a World Bank publication *Creditor Rights and Insolvency Standard*[7].

So, while the UK has scored nearly top marks since the 2015 table for the outcome of insolvency (sale as a going concern as opposed to a piecemeal sale), on the commencement of proceedings, the management of the debtor's assets, the cost to the estate and the recovery rate, our scores are much poorer than the USA on the new measures of reorganisation proceedings and creditor participation.

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The World Bank uses a descriptor of overall performance called 'distance to frontier' meaning the distance to the 'best performance across all economies in the Doing Business sample since 2005.' The UK's resolving insolvency – distance to frontier, with the new measures, fell from 95.33 to 82.04, while the USA (and other countries) went ahead of us. The USA went from a distance to frontier score of 87.72 to 89.20.

A big 'so what?' is a perfectly natural response. In the UK insolvency takes on average one year as opposed to one and a half years in the USA, the cost to the estate is 2 per cent less here than in the USA and the return to creditors is 8.2 cents in the dollar higher. To Britons our insolvency system, while not perfect, is excellent and that must be so because of the number of companies that flock here from around the globe to restructure. The obvious point here is that companies from abroad flock here to use the scheme of arrangement, which is nothing to do with the insolvency laws, and take advantage of the concentration of high quality professional expertise of great integrity and a legal and judicial system that is held in the highest esteem worldwide. The attraction of the UK to foreign debtors and creditors doesn't lie in the administration procedure.

Chaper 11 in disguise?

In May 2016, the Insolvency Service put out consultation proposals for the reform of UK insolvency law. Of the four central proposals below, the government is pressing ahead with three:

- A moratorium procedure, management remaining in control as debtor in possession.
- An extension of the 'essential suppliers' regime enabling debtors to specify contracts that then can't be terminated by reason of the debtor's financial distress.
- A new plan of reorganisation that goes further than any current UK procedure, including the scheme of arrangement, by permitting the cramming down of a whole class of creditors who don't support the plan.
- Super priority rescue finance or DIP lending.

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The fourth proposal, as was the case when it was previously canvassed in 2009, is not going forward.

There is, undoubtedly, something Chapter 11ish about the proposals. In his forward Sajid Javid, the former Secretary of State at the then Department for Business, Innovation and Skills, said:

'To remain at the forefront of insolvency best practice we also need to ask what a "good" regime looks like in 2016. An increasing international focus on company rescue has helped to shift the perceptions of what constitutes best practice; the UK needs to reflect this if our businesses, investors and creditors are to remain confident that the best outcomes can be achieved when things go wrong.'

The executive summary references the government's manifesto commitment to the UK being in the top five in the world and number one in Europe in the World Bank's annual *Doing Business* report.

Then, in November last year, the EU Commission came forward with a new draft insolvency regulation that will, if introduced, require EU members to create in their national laws an insolvency framework meeting minimum standards. The framework is uncannily like that envisaged by the World Bank and UNCITRAL and our Insolvency Service.

Familiarity with the USA

I trailed at the beginning of this article that there is a deeper reason for accepting, and actually welcoming, the Insolvency Service's proposals. The insolvency system, the law, the professionals who operate and police the system, the courts that oversee and adjudicate the procedures and disputes, are all part of the essential economic plumbing for an economy. The purpose of the EU Commission's ambitious insolvency harmonisation plan, something never attempted before, is to be an important part of creating Europe's single capital market. The 'Five Presidents Report' of June 2015[8] lists 'insolvency law among the most important bottlenecks preventing the integration of capital markets in the euro and beyond.'

If the system doesn't work efficiently and predictably then investors will choose someplace else to invest. In deciding the attributes, the emphasis and bias of the insolvency system towards the debtor or the creditor, there is no right or wrong answer other than the pragmatic one of what best promotes successful economic activity. The UK's insolvency regime is a product of our social and economic culture and, since the Cork Report, has held a conscious and deliberate aim of fostering a rescue culture.

Capital providers are most at home, and find it easiest to price insolvency risk, when the insolvency regime is not only efficient but also familiar. The capital markets are more international now than ever and money scours the world for investment opportunities. The hedge fund industry is a huge provider of capital for corporate restructurings and the simple truth is that they and a vast majority of the big sources of capital are either US based or have a strong US character[9] and it is the US restructuring and insolvency regime with which they are most familiar. I don't think that an investor in a new deal will be attracted because the applicable insolvency regime is familiar, but an unfamiliar system can certainly deter them from putting up their money or doing so at a keen price. Furthermore, in a world where enterprises have larger and far more complex capital structures than in the past, investors in all those different instruments and layers of debt want a system that gives them a voice in the restructuring. Our current administration procedure responds well to a secured creditor but bond-holders, unsecured lenders of different rankings, simply don't have the representation that they do in a Chapter 11 designed to accommodate an atomised constituency of creditors.

With so many countries reforming their insolvency laws to attract business and to smooth and enable the flow of capital the UK, with Brexit imminent, and a fight on its hands to retain its position as a key capital market and centre for restructuring, must be at the forefront of reform to attract investors. ◻

1 The World Bank *Doing Business* Report www.doingbusiness.org
2 See 'The wrangling behind the World Bank business stats beyond brics' www.ft.com/content/5e09fd45-a691-304e-8f86-7d2bc86ob70f
3 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf
4 Proposal for a Regulation of the European Parliament and of the council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings http://ec.europa.eu/justice/civil/files/insolvency-regulation_en.pdf
5 Principles for effective insolvency and creditor and debtor regimes http://documents.worldbank.org/curated/en/518861467086038847/pdf/106399-WP-REVISED-PUBLIC-ICR-Principle-Final-Hyperlinks-revised-Latest.pdf

> "The purpose of the EU Commission's ambitious insolvency harmonisation plan is to be an important part of creating Europe's single capital market."

6 UNCITRAL Legislative Guide on Insolvency Law http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf
7 Creditor rights and insolvency standard http://siteresources.worldbank.org/GILD/ConferenceMaterial/20774191/ICR_Standard_21_Dec_2005_Eng.pdf
8 The Five Presidents' Report: Completing Europe's Economic and Monetary Union http://ec.europa.eu/priorities/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en
9 The United States remains the largest centre of investment, with US-based funds managing around 70 per cent of global assets at the end of 2011 per TheCityUK (2012). 'Hedge Funds: March 2012'. TheCityUK's, 'UK fund management: An attractive proposition for international funds' report, released in 2014, reveals that UK assets under management reached a record £6.8tn at the end of 2014.

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